No. 80-1252

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In the Supreme Court of the United States

OCTOBER TERM, 1980

COMMONWEALTH OF PUERTO RICO, PETITIONER

v.

DONALD T. REGAN,
SECRETARY, DEPARTMENT OF THE TREASURY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether Section 7652(a)(3) of the Internal Revenue Code of 1954 (26 U.S.C.) requires that the federal excise tax collected, pursuant to Sections 4081-4083 of the Code, on gasoline sold in the United States be covered into the treasury of Puerto Rico insofar as it is collected on the sale of gasoline refined in Puerto Rico.

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the district court (Pet. App. 44a-58a) is not yet officially reported. The opinion of the court of appeals (Pet. App. 1a-41a) is not yet officially reported.

JURISDICTION

The judgment of the court of appeals was entered on October 17, 1980. The court denied a timely petition for rehearing with a suggestion for rehearing

en banc on December 18, 1980 (Pet. App. 59a-62a). The petition for a writ of certiorari was filed on January 23, 1981. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES AND REGULATION INVOLVED

The relevant provisions of the Act of Apr. 12, 1900, ch. 191, 31 Stat. 77 (commonly known as the Foraker Act); of the Act of Mar. 2, 1917, ch. 145, 39 Stat. 951 (commonly known as the Jones Act); of Sections 4081, 4082, 4083, 7652 and 7653 of the Internal Revenue Code of 1954 (26 U.S.C.; and of Section 48.4081-1 of the Treasury Regulations on Manufacturers and Retailers Excise Taxes (1954 Code) (26 C.F.R.), are set forth in the App., *infra*, 1a-8a.

STATEMENT

1. In this action brought against the Secretary of the Treasury, petitioner seeks a declaratory judgment that Section 7652(a)(3) of the Internal Revenue Code of 1954 (26 U.S.C.)[1] requires that the excise tax collected, pursuant to the provisions of Sections 4081-4083 of the Code, on the sale in the United States of gasoline refined in Puerto Rico be covered into the treasury of Puerto Rico, and an order compelling the Secretary[2] to cover into the treasury

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[1] In its petition, as well as in the courts below, petitioner has referred primarily not to Section 7652(a)(3) of the 1954 Code, but to the similarly worded proviso in 48 U.S.C. 734. Title 48 of the United States Code has never been enacted into law.

[2] When this action was instituted, the named defendant, then Secretary of the Treasury, was William E. Simon. Pursuant to Fed. R. Civ. P. 25(d), Fed. R. App. P. 43(c), and Rule 40.3 of the Rules of this Court, has successors as Secre-

of Puerto Rico the amount of those taxes previously collected and to be collected in the future on the sale of such gasoline in the United States.[3]

The pertinent facts are undisputed and may be summarized as follows: During the fiscal year 1956-1957, Puerto Rican manufacturers began to refine and ship gasoline to the United States. The sale of this gasoline was subject to a tax that has been levied since 1932 on all gasoline sold by a producer or importer in the United States. Revenue Act of 1932, ch. 209, Section 617, 47 Stat. 266 (now Sections 4081-4083 of the Internal Revenue Code of 1954 (26 U.S.C.)). None of the revenues derived from the tax on the sale in the United States of gasoline refined in Puerto Rico has been covered over to Puerto Rico (Pet. App. 4a).

In correspondence dated September 13, 1974, to the Secretary of the Treasury, petitioner claimed for the first time that both past and future taxes collected under the Internal Revenue Code of 1954 on the sale

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tary of the Treasury have automatically been substituted. References to "respondent" are to the particular Secretary in office at the pertinent time.

[3] A similar claim has been made by the Virgin Islands under Section 7652(b)(3) of the Internal Revenue Code of 1954 in *Virgin Islands* v. *Blumenthal*, Nos. 79-1021 & 79-1022 (D.C. Cir. Oct. 17, 1980), petition for a writ of cert. pending, No. 80-1253. In that case, the Virgin Islands claims that it is entitled under Section 7652(b)(3) of the 1954 Code to the tax collected on the sale in the United States of gasoline refined in the Virgin Islands. The controlling provision of the statute, upon which the Virgin Islands relies, is in all essential respects identical to that upon which petitioner relies (Pet. App. 6a-7a). Unlike petitioner, however, the Virgin Islands also claims the custom duties collected on items coming into the United States from the Virgin Islands.

We are serving a copy of this brief upon counsel for the Virgin Islands in No. 80-1253.

in the United States of gasoline refined in Puerto Rico be covered into the treasury of Puerto Rico. Petitioner grounded this claim upon its construction of Section 7652(a)(3) of the 1954 Code (Pet. App. 4a-5a). In accordance with the opinion of the Office of Legal Counsel, Department of Justice (I-P.R.A. 11, 60-71),[4] the Acting Secretary of the Treasury rejected petitioner's claim on June 10, 1975 (Pet. App. 5a; I-P.R.A. 11, 59). The Acting Secretary concluded that the only taxes to be covered into the treasury of Puerto Rico under Section 7652(a)(3) were, according to its terms, those taxes imposed on certain articles that are "produced in Puerto Rico and transported to the United States";[5] that the only taxes thus imposed were the equalization taxes under Section 7652(a)(1); that the tax imposed by Sections 4081-4083 of the 1954 Code was by virtue of the sale of gasoline in the United States, not by virtue of its production in Puerto Rico and transportation to the United States, and therefore was not to be covered into the treasury of Puerto Rico (I-P.R.A. 60-61).

Following the Secretary's rejection of its claim, petitioner brought this action in the United States District Court for the District of Columbia. In an unpublished order, the district court denied the Secretary's motion to dismiss the complaint on the ground that the court had no jurisdiction to hear the complaint (I-P.R.A. 7, 72, 131).

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[4] "I-P.R.A." and "II-P.R.A." references are respectively to Volumes I and II of the separately bound record appendix filed in the court of appeals.

[5] Section 7652(a)(3) also provides for covering into the treasury of Puerto Rico taxes collected on articles "consumed in the island," but that provision is not involved in this case.

On the merits, the district court held that petitioner was entitled to the excise tax collected on the sale in the United States of gasoline refined in Puerto Rico, but limited petitioner's recovery of the past tax revenues to those collected after September 13, 1974, when petitioner first presented its claim to the Secretary. The district court determined that the terms of Section 7652(a)(3) were all-inclusive so that the taxes to be "covered over" to the treasury of Puerto Rico were not limited to taxes levied under Section 7652(a)(1) of the Code (analogous to the Foraker Act taxes). It was the district court's view that the phrase "produced in Puerto Rico and transported to the United States" in Section 7652(a)(3) was simply a description of certain articles, that all internal revenue taxes of the United States involving such Puerto Rican goods were to be covered into the treasury of Puerto Rico, and that the statute included the tax on the sale in the United States of gasoline refined in Puerto Rico. The district court further found that the tax on gasoline sold was in all respects similar to the liquor and tobacco taxes, the revenues from which have traditionally been covered over to petitioner (Pet. App. 5a-7a, 44a-58a).

In so holding, the district court rejected the Secretary's argument that covering over the gasoline tax was barred by the provisions of the Highway Revenue Act of 1956, ch. 462, Section 209(c)(1)(A), 70 Stat. 398 (23 U.S.C. 120 note), which allocates 100% of the tax collected on the sale of gasoline to the "Highway Trust Fund." Although the district court recognized that its decision might be inconsistent with the policies underlying the Highway Act, it stated that it did not conflict with the terms of the Act. Finally, the district court limited petitioner's recovery to the taxes collected after September 13, 1974, under the doctrine of laches. It concluded that

petitioner had slept on its rights and had thus lulled Congress into thinking that petitioner was not entitled to the gasoline tax under Section 7652(a)(3) (Pet. App. 5a, 7a, 44a-58a).

2. On appeals by both parties, the court of appeals reversed (Pet. App. 1a-41a). It held that petitioner was not entitled under Section 7652(a)(3) to the revenues from the sale in the United States of the gasoline refined in Puerto Rico. Upon examination of the language of the relevant Acts, their legislative history, and the administrative construction of those Acts, the court concluded that the phrase "produced in Puerto Rico and transported to the United States" referred to the events that trigger the imposition of such taxes that are to be covered into the treasury of Puerto Rico. The court of appeals reasoned that any other interpretation would lead to the absurd result of requiring the Secretary to turn over to petitioner the tax (*e.g.*, gift, estate, or sale or other excise tax) on any transaction in the United States in which Puerto Rican goods were involved. The court accordingly concluded that the only taxes to be turned over to petitioner were the equalization taxes imposed by Section 7652(a)(1), and that the tax on the sale of gasoline was not an equalization tax. In so holding, the court did not address the jurisdictional issues of sovereign immunity, the tax exception to the Declaratory Judgment Act, and the statute of limitations, raised by the Secretary's appeal.[6] Moreover, the court found it unnecessary to discuss the issue of laches or the Secretary's

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[6] In view of this action, we have filed a conditional cross-petition on behalf of the Secretary of the Treasury. That petition seeks review by this Court only if it grants Puerto Rico's petition in this case or that of the Virgin Islands (No. 80-1253).

contention with respect to the Highway Revenue Act (Pet. App. 1a-40a).

ARGUMENT

1. The court of appeals correctly held that Section 7652(a)(3) of the Internal Revenue Code of 1954 does not require federal excise taxes collected on gasoline refined in Puerto Rico and sold in the United States to be paid over to the treasury of Puerto Rico.

Section 7652(a)(3) of the Internal Revenue Code of 1954, App., *infra*, 3a, provides that—

> All taxes collected under the internal revenue laws of the United States on articles produced in Puerto Rico and transported to the United States (less the estimated amount necessary for payment of refunds and drawbacks), or consumed in the island, shall be covered into the treasury of Puerto Rico.

Petitioner argues (Pet. 7-10) that the phrase "[a]ll taxes" encompasses the gasoline taxes at issue here. There is no question that the Secretary is required to cover over all the taxes described in Section 7652(a)(3). As the court below properly recognized (Pet. App. 10a), the crucial phrase in Section 7652(a)(3) for purposes of determining which taxes are to be covered into the Treasury of Puerto Rico is "taxes * * * on articles produced in Puerto Rico and transported to the United States." This phrase is, as the court of appeals observed (Pet. App. 10a), ambiguous.[7] The words permit a reading, advanced

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[7] Given the ambiguity of the controlling statute, *TVA* v. *Hill*, 437 U.S. 153 (1978), upon which petitioner relies (Pet. 7-9), is irrelevant. There, the Court observed that "[o]ne would be hard pressed to find a statutory provision whose terms were any plainer than those in § 7 of the Endangered Species Act" (437 U.S. at 173).

by the Secretary, that the taxes to be covered over are those that are imposed because certain articles have been produced in Puerto Rico and transported to the United States, *i.e.*, the equalization taxes imposed by Section 7652(a)(1). The words also permit a reading, advanced by petitioner (Pet. 7-8), that the taxes are on any transaction involving certain described articles, *i.e.*, those produced in Puerto Rico and transported to the United States. After a detailed analysis, the court of appeals concluded that the phrase "taxes * * * on articles produced in Puerto Rico and transported to the United States" meant taxes imposed by virtue of the fact that certain articles are so produced and transported (Pet. App. 10a-11a).

The correctness of the decision below is confirmed by the terms and the history of the related provision set forth in Section 7652(a)(1), App., *infra*, 2a. That statute provides for the imposition of taxes on "articles of merchandise of Puerto Rican manufacture coming into the United States" at the same rate as the taxes "imposed in the United States upon the like articles of merchandise of domestic manufacture." Section 7652(a)(2), App., *infra*, 2a, in turn authorizes the Secretary to allow for payment of these taxes before shipment from Puerto Rico. These two companion provisions clearly indicate an assumption that the taxes will be payable by virtue of the taxed articles' having been "transported to the United States" rather than on account of some subsequent transaction. The taxes imposed on manufacturing a product in Puerto Rico and transporting it to the United States are readily collectible. These are the taxes that the court of appeals correctly held payable to petitioner under Section 7652(a)(3).

If, as petitioner urges (Pet. 7-8), the phrase "on articles produced in Puerto Rico and transported to the United States" is simply a description of certain articles, then the taxes to be covered over are those imposed in the United States on any transaction involving a Puerto Rican article. Under that view, if the transfer of such a Puerto Rican article in the United States results in a gift, estate or sales tax, that tax should, according to petitioner, be covered into the treasury of Puerto Rico. To state such a bizarre conclusion is to refute it. As the court of appeals correctly noted (Pet. App. 9a-10a), "[t]he administrative problems inherent in such a reading of the cover over provision are truly staggering. To effectuate this interpretation, Congress would have to separate Puerto Rican goods from other articles before sale, after sale, and throughout the useful life of the article, or else develop tracing procedures for every type of article that Puerto Rico transports to the United States." [8]

These administrative problems are present with respect to petitioner's claim for the tax on the sale in the United States of gasoline refined in Puerto

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[8] As a simple example, it might be noted that Section 4271 of the Internal Revenue Code of 1954 imposes a tax upon the transportation of property by air. If petitioner's reading of Section 7652(a)(3) were correct, it would be necessary to develop some procedure to determine the origin of the contents of every parcel shipped by air in the United States, so that, if the contents had at any time in the past been produced in Puerto Rico and thereafter been transported to the United States, the tax on that shipment could be covered over to the treasury of Puerto Rico. The parallel problem with respect to goods originating in the Virgin Islands would be present under the reading of Section 7652(b)(3) by the Virgin Islands.

Rico. The operation of Sections 4081-4083, imposing a tax upon the sale of gasoline, is such that the taxable transaction may come about only when a local distributor sells gasoline to a retailer.[9] *Gurley* v. *Rhoden*, 421 U.S. 200 (1975).[10] The statute neither establishes nor suggests any mechanism for identifying the origin of the gasoline transferred at the time of taxable sale. Moreover, the rate of tax has changed from time to time,[11] and the applicable rate is the rate prevailing at the time of the taxable sale.[12] Because there is no mechanism, either by statute or regulation, for establishing the origin of gasoline that

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[9] Section 4081 provides that the importer or producer will pay the tax on the sale of gasoline. Section 4082(a) defines "producer" broadly to include distributors, wholesalers and anyone who buys gasoline tax-free. And Section 4083 provides that sales by importers or producers to other producers shall be exempt from tax. See also exemptions in Sections 4221, 6420, 6421; and Section 48.4083-1, Treasury Regulations on Manufacturers and Retailers Excise Taxes (1954 Code) (26 C.F.R.).

[10] In that case, even the retailer was considered the producer because the retailer had purchased the gasoline free of tax.

[11] The current tax is 4 cents per gallon, with the provision in Section 4081(b) that on or about October 1, 1984, the tax shall be 1½ cents per gallon (26 U.S.C. (Supp. III)). When the Internal Revenue Code of 1954 was enacted, the rate was 2 cents per gallon, with the provision in Section 4081 that on or after April 1, 1955, the rate should be 1½ cents per gallon (26 U.S.C. (1952 ed. Supp. II)). For interim changes, see, *e.g.*, Highway Revenue Act of 1956, ch. 462, Section 205, 70 Stat. 389; Federal-Aid Highway Act of 1961, Pub. L. No. 87-61, Section 201(b), 75 Stat. 123.

[12] Section 48.4081-1(b), Treasury Regulations on Manufacturers and Retailers Excise Taxes (1954 Code) (26 C.F.R.), App., *infra*, 4a.

is the subject of a taxable sale, there is likewise no mechanism for establishing when gasoline of Puerto Rican origin is in fact sold, and hence what amount of tax should, under petitioner's reading, be covered over before and after the time when the rate changes.

In sum, petitioner's claim (Pet. 7-9) that its construction of Section 7652(a)(3) is the only permissible one is refuted by the complementary relationship between that provision and Section 7652(a)(1). The court below was therefore fully justified in concluding that the "taxes" referred to in Section 7652(a)(3) are those equalization taxes imposed because certain articles have been produced in Puerto Rico and transported to the United States.

2. The history of the controlling statute fully supports—indeed requires—the court of appeals' conclusion that Congress intended in Section 7652(a)(3) to cover over only those taxes laid for equalization purposes. These are the taxes imposed by Section 7652(a)(1).

Shortly after Puerto Rico was acquired by the United States,[13] Congress passed the Act of Apr. 12, 1900, ch. 191, 31 Stat. 77 (commonly known as the Foraker or First Organic Act), establishing a civilian government and providing revenues for the island's support. The provisions of the Act establish a significant part of the legislative framework for this case. Congress believed that the excise taxes that then characterized the internal revenue system of the United States[14] would unduly burden the people

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[13] Treaty of Peace between the United States and the Kingdom of Spain, Dec. 10, 1898, Art. II, 30 Stat. 1755.

[14] It was characteristic of all of these excise tax statutes in force on January 1, 1900, and of earlier and later excise

of Puerto Rico (H.R. Rep. No. 249, 56th Cong., 1st Sess. 16 (1900)). Accordingly, Congress provided in Section 14 of the Foraker Act, 31 Stat. 80, App., *infra*, 7a, that "the internal-revenue laws * * * shall not have force and effect in Porto Rico." This would have left manufacturers in the United States, and particularly manufacturers of alcohol and tobacco products who were subject to substantial excise taxes [15] on manufacture, vulnerable to tax-free competition from Puerto Rico (Pet. App. 12a-13a). In order to avoid such a result, Congress provided in Section 3 of the Foraker Act, 31 Stat. 77, App., *infra*, 4a-6a, that articles manufactured in Puerto Rico and brought to the United States should be subject to tax at the rate applicable to like articles manufactured in the United

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statutes prior to the Revenue Act of 1917, ch. 63, 40 Stat. 300, that the tax was stated to be on a named article "manufactured," "manufactured and sold," "distilled," "brewed or manufactured and sold," "imported from foreign countries," etc. See, *e.g.*, *Internal Revenue Laws in Force January 1, 1900*, Treas. Dep't Doc. No. 2157 (1900). The War Excise Taxes imposed by Title VI of the Revenue Act of 1917, 40 Stat. 316 *et seq.*, appear to be the first upon the sale of named articles, *e.g.*, upon automobiles, phonographs, jewelry, perfumes, etc., "sold by the manufacturer, producer, or importer" (Section 600, 40 Stat. 316).

[15] At that time, taxes were imposed, for example, on spirits distilled in the United States (Act of Aug. 27, 1894, ch. 349, Section 48, 28 Stat. 563), on tobacco manufactured and sold (Rev. Stat., Section 3368, as amended by the Act of Oct. 1, 1890, ch. 1244, Section 31, 26 Stat. 619, and by the Act of June 13, 1898, ch. 488, Section 3, 30 Stat. 449), and on tobacco imported from foreign countries (Rev. Stat., Section 3377, as amended by the Act of Mar. 1, 1879, ch. 125, Section 14, 20 Stat. 343). Puerto Rico was no longer a foreign country. *DeLima* v. *Bidwell*, 182 U.S. 1, 181-200 (1901); *Downes* v. *Bidwell*, 182 U.S. 244, 248-249 (1901).

States.[16] That provision remains, and now appears as Section 7652(a)(1) of the 1954 Code. Until the local Puerto Rican government was established by Presidential Proclamation,[17] the proceeds of that tax were set aside for use for the benefit of Puerto Rico. But after that government was established, those proceeds were paid into the general fund of the Treasury (Section 4 of the Foraker Act, 31 Stat. 78, App., *infra*, 6a-7a).

It is clear, as the court of appeals pointed out (Pet. App. 15a), that Section 3 of the Foraker Act (now Section 7652(a)(1) of the 1954 Code) "impos[es] an equalization tax, as a condition of entry into the mainland market, on any Puerto Rican article that has escaped a tax previously laid on comparable American-made articles. Only when tax equalization function is needed does the Foraker provision come into play. Furthermore, * * * only domestic taxes on manufacture [*e.g.*, taxes on alcohol distilled and tobacco manufactured] require such equalization. Any tax that applies equally to Puerto Rican and mainland goods, such as a tax on sale, does not require the application of a 'mirror-like' equalization tax."

In 1917, when the customs revenues of Puerto Rico sharply declined because Europe was at war, and

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[16] In Section 3, Congress also provided that articles manufactured in the United States and brought into Puerto Rico should be subject to tax at the rate applicable to like articles manufactured in Puerto Rico. That provision is the predecessor of Section 7653(a)(1) of the Internal Revenue Code of 1954, App., *infra*, 3a. The amounts collected in Puerto Rico under that part of the Foraker Act were paid into the treasury of Puerto Rico after the Proclamation of the President referred to at note 17, *infra*.

[17] The Proclamation (No. 8) was made on July 25, 1901. 32 Stat. 1983.

the Puerto Rican government was in need of added revenues, Congress enacted Section 9 of the Act of Mar. 2, 1917, ch. 145, 39 Stat. 954 (commonly known as the Jones Act or Second Organic Act). That statute is now codified in Section 7652(a)(3). As the court below observed (Pet. App. 16a-23a), the legislative history of Section 7652(a)(3) demonstrates that the taxes to be covered over by this section were the Foraker Act equalization taxes. The House Committee on Insular Affairs stated in pertinent part (H.R. Rep. No. 77, 64th Cong., 1st Sess. 1-2 (1916); emphasis added) that "the present rule is to pay * * * into the Treasury of the United States internal-revenue taxes collected on articles produced in Porto Rico but transported to the United States. In the opinion of your committee *these taxes* should all be covered into the treasury of Porto Rico." The Senate made the covering over provision of the Jones Act coextensive with the Foraker Act by adding the phrase "consumed in the island" (S. Rep. No. 579, 64th Cong., 1st Sess. 2 (1916)).[18] Contrary to petitioner's claim (Pet. 10 n.10), this phrase referred only to the taxes imposed on United States manufactured goods entering Puerto Rico (now Section 7653(a) of the 1954 Code). Petitioner has pointed to no other internal revenue tax relating to Puerto Rico other than the Foraker Act taxes. Indeed, the first part of Section 9 of the Jones Act made the internal revenue laws of the United States inapplicable to Puerto Rico.

3. Petitioner further challenges (Pet. 11-12) the court of appeals' conclusion (Pet. App. 27a-33a) that the administrative construction of the statute by the Treasury is entitled to great weight. But the

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[18] Of course, as petitioner points out (Pet. 10), the Senate made the covering-over provision "all inclusive," *i.e.*, all-inclusive for the Foraker Act taxes (S. Rep. No. 579, *supra*, at 2).

Treasury has been charged with the collection of the taxes under Section 3 of the Foraker Act and its successors, as well as other excises, and with the payment of funds under Section 9 of the Jones Act and its successors in the 1939 and 1954 Codes. As the court below correctly noted (Pet. App. 28a-30a), the Treasury has consistently interpreted the controlling provision (Section 7652(a)(3) or its predecessors), for more than half a century, to require the covering over of only equalization (Foraker Act) taxes; and taxes, such as the gasoline tax, on sales at wholesale or retail are not equalization (Foraker Act) taxes. Congress was aware of this administrative interpretation. See Rev. Rul. 58-554, 1958-2 Cum. Bull. 909, which spells out in detail the administrative interpretation of the Foraker equalization tax provision (Section 7652(a)(1) of the 1954 Code). Indeed, until this case, petitioner has never challenged the Treasury's interpretation. In these circumstances, the Treasury's consistent and longstanding construction should be accorded substantial deference. *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978); *Saxbe* v. *Bustos*, 419 U.S. 65, 74 (1974). See also *Central Tablet Manufacturing Co.* v. *United States*, 417 U.S. 673, 689-690 (1974).

The fact that the Secretary asserted claims of privilege with respect to certain documents requested by petitioner does not, as petitioner argues (Pet. 11-12), undermine the deference to be accorded the Treasury's administrative construction of the statute.[19] The

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[19] The only document cited by petitioner (Pet. 12 n.13) as showing an inconsistent administrative practice is an

district court determined that the documents were within the claimed privileges (I-P.R.A. 156). Petitioner did not appeal this determination and makes no claim that the district court erred. If a document is privileged, the weight of authority is that no inference is to be drawn against the party asserting the privilege. Otherwise the rationale behind allowing the privilege would be destroyed. *Griffin* v. *California*, 380 U.S. 609, 614 (1965); 2 J. Wigmore, *Evidence* § 291(3)(2), at 225 (Chadbourn rev. 1979); *McCormick on Evidence* § 76 (2d ed. 1972). Indeed, the McCormick treatise states that where, as here, the government is the defendant, "an adverse finding cannot be rendered against it as the price of asserting an evidentiary privilege. This is not one of the terms upon which Congress has consented that the United States be subject to liability." *McCormick on Evidence, supra*, § 109, at 234.[20]

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otherwise unidentified memorandum referred to in the course of an extensive Treasury memorandum on S. 1014, 80th Cong., 1st Sess. (1947) (II-P.R.A. 360-364). But this unidentified document does not assist petitioner. It does indicate that some unidentified person in the Miscellaneous Tax Unit gave Section 3360(c) of the 1939 Code (26 U.S.C. (1952 ed.)) (now Section 7652(a)(3) of the 1954 Code) the reading that would require covering over to petitioner retail sales taxes, and presumably gift, estate and income taxes if they arose by virtue of transfers or other transactions involving articles of Puerto Rican origin. These are consequences that petitioner acknowledged to be "absurd" in its brief in the court of appeals (at 5 n.7), and they were firmly rejected by the Secretary as well. See the O'Connell letter, referred to by the court below (Pet. App. 28a-30a) for the views expressed by the Treasury to the Senate with respect to S. 1014.

[20] Fed. R. Civ. P. 26(b)(1) provides that privileged documents are not subject to discovery. The cases cited by petitioner (Pet. 12) are inapposite. In *Washington* v. *Cameron*, 411 F.2d 705 (D.C. Cir. 1969), and in *Illinois State*

4. a. Petitioner also argues (Pet. 12-17) that the tax imposed on "gasoline sold" in the United States is a tax on manufacturing and not a tax on sale and that the only manner in which gasoline coming from Puerto Rico may be subject to tax is under Section 7652(a)(1) of the Code. But, as the court below correctly stated (Pet. App. 36a), "[t]he crucial inquiry is whether the gasoline tax is laid on the act of sale or manufacture." The tax imposed by Section 4081 is on the sale of gasoline, not on its manufacture or refinement. Indeed, this Court in *Gurley* v. *Rhoden*, *supra*, 421 U.S. at 205, recognized that the tax was upon "gasoline sold." There, the Court stated that the gasoline tax was levied on the sale by a person who had purchased the gasoline tax-free.

This Court has also considered similar statutory language to be a tax on sales, and not on manufacturing. *Indian Motocycle Co.* v. *United States*, 283 U.S. 570, 574 (1931). See also, *Import Wholesalers Corp.* v. *United States*, 368 F.2d 577 (Ct. Cl. 1966); *Jacobs Equipment Co.* v. *United States*, 574 F.2d 1040 (10th Cir. 1978); *United States* v. *Stowe-Woodward, Inc.*, 306 F.2d 678, 679 (1st Cir. 1962), cert. denied, 371 U.S. 949 (1963). Likewise, Section 48.4081-1(a), Treasury Regulations on Manufacturers and Retailers Excise Taxes (1954 Code)

Employees Union Council 34 v. *Lewis*, 473 F.2d 561 (7th Cir. 1972), cert. denied, 410 U.S. 928, 943 (1973), the issue was whether the district court should have granted summary judgment without considering the interrogatories propounded, but not yet answered. Here, on the other hand, the Secretary answered the interrogatories and withheld only those records or portions thereof that the district court determined to be privileged.

(26 C.F.R.), App., *infra*, 3a, provides that "Section 4081 imposes a tax on the sale of gasoline * * *."[21]

When Congress has placed a tax on manufacturing or production, it has consistently done so in the Internal Revenue Code and in earlier excise tax statutes by using those precise terms.[22] The statute in *Liggett & Myers Tobacco Co.* v. *United States*, 299 U.S. 383, 384 (1937), upon which petitioner relies (Pet. 16), is accordingly distinguishable. There, the tax was imposed "[u]pon all tobacco and snuff manufactured in or imported into the United States, and hereafter sold by the manufacturer or importer, or removed for consumption or sale * * *." The Court held that the tax was on the manufacturing of tobacco and snuff and not on their sale because, *inter alia*, the tax was based upon each pound of tobacco manufactured regardless of the price obtained upon sale.[23] Whether or not a tax is measured by a percentage of price may help resolve a problem of statutory inter-

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[21] Section 4082(c) of the 1954 Code, App., *infra*, 1a, provides that use of gasoline by the producer or importer is deemed a sale.

[22] See, *e.g.*, tax "on all distilled spirits * * * produced" (Section 5001 of the 1954 Code) or tax "[o]n cigars * * * manufactured" (Section 5701 of the 1954 Code). See also notes 14 & 15, *supra*. Indeed, from the beginning, Congress employed a similar style. Section 15 of the Act of Mar. 3, 1791, ch. 15, 1 Stat. 203, had imposed a tax "upon all spirits * * * distilled within the United States." This excise was repealed by the Act of Apr. 6, 1802, ch. 19, 2 Stat. 148. Thus, a tax on a given article sold is a tax on sale. Petitioner ignores this consistent stylistic pattern used by Congress with respect to the tax laws.

[23] The Court noted that the terms "hereafter sold" or "removed for consumption or sale" marked only the time when the tax was payable (299 U.S. at 386).

pretation when the statute imposes a tax upon an item manufactured and sold, but such a criterion is irrelevant when the statute imposes a tax only on the sale. The manner in which the tax is computed cannot make it a tax on manufacture unless the statute clearly imposes the tax upon the manufacture of a product. The tax under Section 4081 is upon "gasoline sold" and there is nothing in the statute or its legislative history to suggest that the imposition of the tax is on any activity other than its sale.[24] Contrary to petitioner's argument (Pet. 15-17), *Liggett & Myers Tobacco Co.* does not conflict with the decision below. As the court below correctly recognized (Pet. App. 36a-37a), the fact that the tax is imposed upon a sale by the manufacturer or somewhere between the manufacturer and retailer, and is not imposed upon retail sales as such, does not make it any less of a tax on sales. In sum, petitioner's attempt to convert the tax imposed by Sections 4081-4083 on the sale of gasoline into a tax on the refining of gasoline is refuted by the language and operation of the statute.

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[24] The difference between a tax on a product "sold" by the manufacturer, producer, or importer, and a tax on a product "manufactured" rises to constitutional dimensions in at least one context. When the tax on "baseball bats, * * * balls of all kinds, including baseballs * * * sold by the manufacturer" (40 Stat. 316-317) was applied to a shipment of baseballs and bats by the manufacturer to a buyer in Venezuela, this Court in *Spalding & Bros.* v. *Edwards*, 262 U.S. 66, 67 (1923), held that the tax as thus applied violated Art. I, Sec. 9, cl. 5, of the Constitution, providing that "No Tax or Duty shall be laid on Articles exported from any State." On the other hand, when the tax was not on sale, but was on "all filled cheese which shall be manufactured" (Act of June 6, 1896, ch. 337, Section 9, 29 Stat. 255), the tax was upheld even though the filled cheese was manufactured under contract for export. *Cornell* v. *Coyne*, 192 U.S. 418 (1904); cf. *Turpin* v. *Burgess*, 117 U.S. 504 (1886).

b. Petitioner also argues (Pet. 13-14) that under the decision below, gasoline refined in Puerto Rico and transported to the United States will escape taxation. But petitioner ignores the well settled judicial interpretation of the phrase "manufacturer, producer or importer" under the statutes imposing a tax on the sale to be a shorthand expression for first sale in the United States. *Indian Motocycle Co.* v. *United States*, *supra*, 283 U.S. at 574; *United States* v. *Stowe-Woodward, Inc.*, *supra*, 306 F.2d at 679. Here, the term "producer" is defined so broadly in Section 4082(a) as to preclude the possibility that the sale in the United States of Puerto Rican refined gasoline could go untaxed.[25]

The historical relationship between the taxes on tobacco manufactured or imported and on spirits distilled or imported, on the one hand, and the Foraker Act equalization taxes (Section 7652(a)(1) of the 1954 Code), on the other, indicates that the taxes imposed on tobacco and liquor manufactured in Puerto Rico and transported to the United States have consistently been taxes under the Foraker Act equalization tax provisions. As we have noted (*supra*,

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[25] As this Court pointed out in *Gurley* v. *Rhoden*, *supra*, 421 U.S. at 205, Section 4082(a) defines "producer" to include, *inter alia*, "[a]ny person to whom gasoline is sold tax-free." In that case the producer was the operator of several gasoline stations. "Importer" includes "any person who withdraws gasoline from a customs bonded warehouse for sale or use in the United States" (Section 48.4082-1(d) of the Treasury Regulations on Manufacturers and Retailers Excise Taxes (1954 Code) (26 C.F.R.)). Any use of gasoline other than in further production is defined as a sale in Section 4082(c) of the 1954 Code.

It is clear that Congress intended the predecessors of Section 4081(a) to reach the sale of gasoline in the United States by any person making a taxable sale. See 75 Cong. Rec. 7037, 7320 (1932).

pages 11-13), the Foraker Act equalization taxes were enacted because the taxes on tobacco and distilled spirits were on manufacture or on importation from a foreign country. Puerto Rico, however, was no longer a foreign country.[26] Although the taxes on tobacco and distilled spirits are now on their manufacture or on their importation into the United States (Sections 5001(a) and 5701(a) of 1954 Code), Congress has continued to treat the taxes on spirits distilled and tobacco products manufactured in Puerto Rico and transported to this country as being imposed by Section 7652(a)(1). See the amendments made by Section 808 of the Excise Tax Reduction Act of 1965, Pub. L. No. 89-44, 79 Stat. 164, and by Section 1905(a)(2) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1818. Indeed, with respect to the latter amendment, the Senate Finance Committee Report explained (S. Rep. No. 94-938, 94th Cong., 2d Sess. 529 (1976): "Puerto Rico and Virgin Island spirits are taxed separately (under [Section] 7652) [rather than under Section 5001]."[27] In light of this historical devel-

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[26] See *Hooven & Allison Co.* v. *Evatt*, 324 U.S. 652, 669-670 (1945).

[27] Imports from other areas do not cause a tax to be covered into the treasury of Puerto Rico. If tobacco and distilled spirits coming from Puerto Rico are taxed only because they are imports under Sections 5001(a)(1) and 5701, and not because they were produced in Puerto Rico, then the Treasury has been paying too much money to Puerto Rico under Section 7652(a)(3). But this case does not involve the question whether payments have been excessive. The significant matter in this case, as the court below recognized, is that gasoline is taxed because it is "sold," and the tax on sale applies whether the gasoline is refined domestically, in Puerto Rico, or in a foreign country.

opment, there simply is no relevant connection for purposes of this case between the terms "imported" as used in Sections 5001 and 5701 and the term "importer" as used in Section 4081(a).

5. Admittedly, this case involves a substantial amount of money—almost $500 million to date. But the court of appeals' approval of the more-than-half-century interpretation of Section 7652(a)(3) of the Code by the Treasury settles the matter and eliminates the manifold administrative problems created by the district court's decision. For example, the gasoline taxes claimed by petitioner had, prior to the entry of the district court's judgment, been paid by the Secretary into the "Highway Trust Fund," the "Land and Water Conservation Fund", and the "Airport and Airway Trust Fund."[28] Under the de-

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[28] Section 209(c)(1)(A) of the Highway Revenue Act of 1956, ch. 462, 70 Stat. 398, as amended (23 U.S.C. 120 note), appropriated to the Highway Trust Fund "100 percent of the taxes received after June 30, 1956, under * * * [Section] 4081 (tax on gasoline) * * *." Sections 2(c), 201(a) and 202(a) of the Land and Water Conservation Fund Act of 1965, Pub. L. No. 88-578, 78 Stat. 899, 904 (16 U.S.C. 460*l*-5 and 460*l*-11, 23 U.S.C. 120 note), provided for crediting to the land and water conservation fund amounts collected under Section 4081 of the Internal Revenue Code on gasoline sold for use in motorboats and modified Section 209 of Highway Revenue Act of 1956, 70 Stat. 397, accordingly. Section 208(b)(2) of the Airport and Airway Development Act of 1970, Pub. L. No. 91-258, 84 Stat. 250, appropriated the taxes received in the Treasury after June 30, 1970, under Section 4081 of the Internal Revenue Code of 1954, with respect to gasoline used in aircraft, to the Airport and Airway Trust Fund. Section 208(g) of the Act, 84 Stat. 252, modified Section 209(c) of the Highway Revenue Act of 1956 to this end. In *Gurley* v. *Rhoden*, *supra*, 421 U.S. at 206, this Court recognized that the proceeds of the gasoline tax "go not into the

cision below, these gasoline tax revenues are not diverted from the various funds to which Congress intended them to be paid.

Contrary to petitioner's further claim (Pet. 7), the decision below in no way alters the relationship between the United States and Puerto Rico. Indeed, that decision continues the longstanding relationship confirmed by the administrative construction of the statute for more than half a century. The Act of July 3, 1950, ch. 446, 64 Stat. 319 (the Puerto Rican Federal Relations Act of 1950), cited by petitioner (Pet. 7), provides neither support for its claim nor a reason for review of the judgment below. Because of that Act, Congress has normally sought petitioner's approval with respect to legislation applicable to events in Puerto Rico. But Congress apparently neither sought nor obtained petitioner's consent prior to enactment of Section 808 of the Excise Tax Reduction Act of 1965, Pub. L. No. 89-44, 79 Stat. 164, and Section 1905(a)(2) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1818.[29]

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general treasury, but into a special fund used to defray the cost of the federal highway system * * *." And in *Massachusetts* v. *United States*, 435 U.S. 444, 448 (1978), the Court recognized that Congress had provided that the user taxes, which include the gasoline sold for use in aircraft, are paid into the Airport and Airway Trust Fund. Petitioner is entitled to distributions from these funds, but made no contributions thereto. As of September 13, 1974, petitioner had received approximately $250,000,000 from the Highway Trust Fund (II-P.R.A. 214), and nearly $10,000,000 from the other funds.

[29] Apart from its irrelevancy, petitioner's claim (Pet. 7 n.6) that the Act of July 3, 1950, *supra*, cannot be unilaterally

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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changed by the United States is incorrect. That Act, like any other act or treaty, is not binding on a subsequent Congress. *Clark* v. *Allen*, 331 U.S. 503, 509 (1947); *Whitney* v. *Robertson*, 124 U.S. 190, 194 (1888); *The Chinese Exclusion Case*, 130 U.S. 581, 600 (1889).

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 4081. IMPOSITION OF TAX.

(a) *In general.* [as amended by Section 201(b), Federal-Aid Highway Act of 1961, Pub. L. No. 87-61, 75 Stat. 123]—There is hereby imposed on gasoline sold by the producer or importer thereof, or by any producer of gasoline a tax of 4 cents a gallon.

* * * * *

SEC. 4082. DEFINITIONS.

(a) *Producer.* [as amended by Section 201(e)(1), Federal-Aid Highway Act of 1959, Pub. L. No. 86-342, 73 Stat. 615]—As used in this subpart, the term "producer" includes a refiner, compounder, blender, or wholesale distributor, and a dealer selling gasoline exclusively to producers of gasoline, as well as a producer. Any person to whom gasoline is sold tax-free under this subpart shall be considered the producer of such gasoline.

* * * * *

(c) *Certain uses defined as sales.* [as amended by Section 205(c)(6), Airport and Airway Revenue Act of 1970, Pub. L. No. 91-258, 84 Stat. 242]—If a producer or importer uses (other wise than in the production of gasoline or of special fuels referred to in section 4041) gasoline sold to him free of tax, or produced or imported by him, such use shall for the purposes of this chapter be considered a sale.

* * * * *

SEC. 4083. [as amended by Section 1906(b)(13)(A), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1834] EXEMPTION OF SALES TO PRODUCER.

Under regulations prescribed by the Secretary the tax imposed by section 4081 shall not apply in the case of sales of gasoline to a producer of gasoline.

SEC. 7652. SHIPMENTS TO THE UNITED STATES.

(a) *Puerto Rico.*—

(1) *Rate of tax.* [as amended by Section 204(17), Excise Tax Technical Changes Act of 1958, Pub. L. No. 85-859, 72 Stat. 1430]—Except as provided in section 5314, articles of merchandise of Puerto Rican manufacture coming into the United States and withdrawn for consumption or sale shall be subject to a tax equal to the internal revenue tax imposed in the United States upon the like articles of merchandise of domestic manufacture.

(2) *Payment of tax.* [as amended by Section 1906(b)(13)(A), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1834]—The Secretary shall by regulations prescribe the mode and time for payment and collection of the tax described in paragraph (1), including any discretionary method described in section 6302(b) and (c). Such regulations shall authorize the payment of such tax before shipment from Puerto Rico, and the provisions of section 7651(2)(B) shall be applicable to the payment and collection of such tax in Puerto Rico.

(3) *Deposit of internal revenue collections.* [as amended by Section 808(b)(3), Excise Tax Reduction Act of 1965, Pub. L. No. 89-44, 79 Stat. 164]—All taxes collected under the internal revenue laws of the United States on articles produced in Puerto Rico and transported to the United States (less the estimated amount necessary for payment of refunds and drawbacks), or consumed in the island, shall be covered into the treasury of Puerto Rico.

* * * * *

SEC. 7653. SHIPMENTS FROM THE UNITED STATES.

(a) *Tax Imposed.*—

(1) *Puerto rico.*—All articles of merchandise of United States manufacture coming into Puerto Rico shall be entered at the port of entry upon payment of a tax equal in rate and amount to the internal revenue tax imposed in Puerto Rico upon the like articles of Puerto Rican manufacture.

(2) *Virgin Islands.*—There shall be imposed in the Virgin Islands upon articles imported from the United States a tax equal to the internal revenue tax imposed in such islands upon like articles there manufactured.

* * * * *

Treasury Regulations on Manufacturers and Retailers Excise Taxes (1954 Code) (26 C.F.R.):

§ 48.4081-1 *Imposition and rates of tax.*

(a) *In general.* Section 4081 imposes a tax on the sale of gasoline by the producer or importer thereof, or by any producer of gasoline,

regardless of when or whether such gasoline was produced by him. For the requirement that producers and importers of gasoline be registered and give bond, see section 4101 and the regulations thereunder. See section 4082(c) and paragraph (c) of § 48.4082-1 for certain uses of gasoline that shall be considered sales of gasoline.

(b) *Rate of tax.* Tax is imposed on the sale of gasoline at the rate applicable on the date on which the gasoline is sold. Following are the rates in effect on or after January 1, 1959:

Gasoline sold	Cents per gallon
(1) January 1, 1959, to September 30, 1959, inclusive	3
(2) October 1, 1959, to September 30, 1972, inclusive	4
(3) On or after October 1, 1972	1½

(c) *Liability for tax.* The tax imposed by section 4081 is payable by the producer or importer making the sale of the gasoline.

Act of Apr. 12, 1900, ch. 191, 31 Stat. 77 *et seq.*:

* * * * *

SEC. 3. That on and after the passage of this Act all merchandise coming into the United States from Porto Rico and coming into Porto Rico from the United States shall be entered at the several ports of entry upon payment of fifteen per centum of the duties which are required to be levied, collected, and paid upon like articles of merchandise imported from foreign countries; and in addition thereto upon articles of merchandise of Porto Rican manufacture coming into the United States and withdrawn for consumption or sale upon payment of a tax equal to the internal-revenue tax imposed in the United States upon the like articles of merchandise of

domestic manufacture; such tax to be paid by internal-revenue stamp or stamps to be purchased and provided by the Commissioner of Internal Revenue and to be procured from the collector of internal revenue at or most convenient to the port of entry of said merchandise in the United States, and to be affixed under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and on all articles of merchandise of United States manufacture coming into Porto Rico in addition to the duty above provided upon payment of a tax equal in rate and amount to the internal-revenue tax imposed in Porto Rico upon the like articles of Porto Rican manufacture: *Provided*, That on and after the date when this Act shall take effect, all merchandise and articles, except coffee, not dutiable under the tariff laws of the United States, and all merchandise and articles entered in Porto Rico free of duty under orders heretofore made by the Secretary of War, shall be admitted into the several ports thereof, when imported from the United States, free of duty, all laws or parts of laws to the contrary notwithstanding; and whenever the legislative assembly of Porto Rico shall have enacted and put into operation a system of local taxation to meet the necessities of the government of Porto Rico, by this Act established, and shall by resolution duly passed so notify the President, he shall make proclamation thereof, and thereupon all tariff duties on merchandise and articles going into Porto Rico from the United States or coming into the United States from Porto Rico shall cease, and from and after such date all such merchan-

dise and articles shall be entered at the several ports of entry free of duty; and in no event shall any duties be collected after the first day of March, nineteen hundred and two, on merchandise and articles going into Porto Rico from the United States or coming into the United States from Porto Rico.

SEC. 4. That the duties and taxes collected in Porto Rico in pursuance of this Act, less the cost of collecting the same, and the gross amount of all collections of duties and taxes in the United States upon articles of merchandise coming from Porto Rico, shall not be covered into the general fund of the Treasury, but shall be held as a separate fund, and shall be placed at the disposal of the President to be used for the government and benefit of Porto Rico until the government of Porto Rico herein provided for shall have been organized, when all moneys theretofore collected under the provisions hereof, then unexpended, shall be transferred to the local treasury of Porto Rico, and the Secretary of the Treasury shall designate the several ports and subports of entry in Porto Rico and shall make such rules and regulations and appoint such agents as may be necessary to collect the duties and taxes authorized to be levied, collected, and paid in Porto Rico by the provisions of this Act, and he shall fix the compensation and provide for the payment thereof of all such officers, agents, and assistants as he may find it necessary to employ to carry out the provisions hereof: *Provided, however*, That as soon as a civil government for Porto Rico shall have been organized in accordance with the provisions of this Act and notice thereof shall have been given to the Pres-

ident he shall make proclamation thereof, and thereafter all collections of duties and taxes in Porto Rico under the provisions of this Act shall be paid into the treasury of Porto Rico, to be expended as required by law for the government and benefit thereof instead of being paid into the Treasury of the United States.

* * * * *

SEC. 14. That the statutory laws of the United States not locally inapplicable, except as hereinbefore or hereinafter otherwise provided, shall have the same force and effect in Porto Rico as in the United States, except the internal-revenue laws, which, in view of the provisions of section three, shall not have force and effect in Porto Rico.

* * * * *

Act of Mar. 2, 1917, ch. 145, 39 Stat. 951 *et seq.*:

* * * * *

SEC. 9. That the statutory laws of the United States not locally inapplicable, except as hereinbefore or hereinafter otherwise provided, shall have the same force and effect in Porto Rico as in the United States, except the internal-revenue laws: *Provided, however*, That hereafter all taxes collected under the internal-revenue laws of the United States on articles produced in Porto Rico and transported to the United States, or consumed in the island shall be covered into the treasury of Porto Rico.

* * * * *

SEC. 58. That all laws or parts of laws applicable to Porto Rico not in conflict with any of the provisions of this Act, including the laws

relating to tariffs, customs, and duties on importations into Porto Rico prescribed by the Act of Congress entitled "An Act temporarily to provide revenues and a civil government for Porto Rico, and for other purposes," approved April twelfth, nineteen hundred, are hereby continued in effect, and all laws and parts of laws inconsistent with the provisions of this Act are hereby repealed.

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